



January 2018 Update

The December Quarter is complete and we are now nine months into Blue Boat’s performance record. It has been a successful time with the recent quarter especially profitable. Our performance to date along with some major equity indices’ results are set below.

Blue Boat Performance vs Indices: 3 April 2017 – 31 December 2017:

Blue Boat Gross Return	Blue Boat Net Return	ASX 200	S&P 500	MSCI World
26.8%	26.3%	6.5%	12.0%	12.8%

Returns presented in AUD. Index returns include reinvested dividends.

Equity markets in general have been relatively buoyant and delivered solid returns across the board. We’ve seen equity markets around the world simultaneously reach record levels (the ASX is at a post-GFC high, but still well short of the 2007 mark).

Notwithstanding the rise in prices, we believe markets are not overly expensive and on balance there is further upside potential. Improving corporate earnings expectations, fiscal impulse from infrastructure spending and tax cuts and rising commodity prices each point to stronger earnings growth ahead. This, combined with accommodative interest rates, supports higher valuations for equities.

More technically speaking, our assessment of equity markets indicates that the return premium for equities over bonds is still above the long term average.

In practice we see plenty of opportunities to buy good assets at attractive prices. We have an abundance of buy ideas and not that much we want to sell, which we view as a high quality problem to have.

This highlights a feature of running a concentrated portfolio such as Blue Boat’s. As we come across attractive investment opportunities we are routinely forced to focus on only the best ideas. This leads us to the situation of having to pass/sell good ideas to make room for the truly great ones.

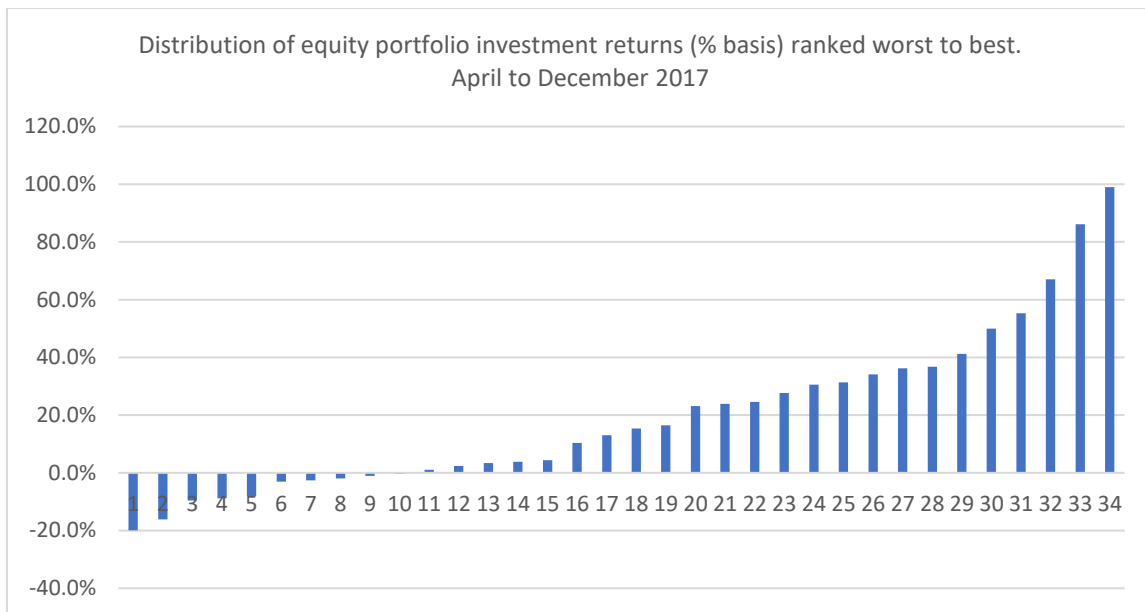
It is easy to want a piece of every good idea, but the discipline of a concentrated portfolio helps us optimise our investments to get the best overall return profile.

Strong market conditions have certainly helped us, but we are very pleased to see positive developments specific to our investments.

Digging into the results shows broad-based success across the portfolio:

- 7 out of 10 investments have made money;
- the average gain has been more than 4x larger than the average loss; and
- the winning investments had about 40% larger capital allocations than the losing ones.

The chart below shows the distribution of these returns ranked by individual investment. The numbers indicate that the overall result is not down to a one off, and that our methods have been effective at spotting attractive opportunities without incurring excessive risk of capital loss.



We don't plan on regularly discussing the holdings in the portfolio, especially regarding anything we are currently active in or planning to buy or sell in the foreseeable future. However, we thought we would sporadically explain certain stocks to give some insights into our thinking, and especially to draw attention to investments that are likely to be very different from anything held in typical portfolios.

We are both avid followers of the legendary American investor Jim Rogers, who has extended his vast fortune by investing in businesses which use proven business models from developed countries and apply them to fast growing developing economies.

The death care industry is a large and profitable one in Australia and in USA. It faces minimal risk from technological disruption and apart from paying tax, the only other certainty in our life is that one day we will all require the services this industry provides. Invocare (ASX code IVC) is the Australian market leader with a \$1.8bn mkt cap and an addressable market of just 25m Australians.

In comparison, China has a population of nearly 1.4bn. The population base is aging and becoming increasingly urbanised (currently 57%). Now there are around 10m urban deaths per year. The Chinese have a strong culture of honouring the dead and as their vast middle class continues to grow, so does their ability to spend on burial ceremonies and grave sites.

Fu Shou Yuan (FSY) is the market leader in the Chinese death care industry growing via government tender and acquisition over the past 23 years, now operating across 17 cities including Shanghai. They have no debt and large cash reserves, as well as over 1.91 million square metres of sanctioned land which is circa 50 years of supply at current growth rates.

FSY operates at the premium end of the market, focussing on elaborate burial plots and ceremonies which are desired by the Chinese middle class. 80% gross profit margins, 29% net profit margins are high but sustainably so as FSY has proven to have pricing power in recent years with high quality offerings and a brand associated with wealth and success.

The past 5 years have seen profits grow by 28.5% compound, a figure we think will increase in the years ahead as this year is the first that FSY has offered pre-payment for funerals. This practice which

started in USA and Australia creates a "float", similar to an insurance company, which can be invested by the operator. Income from this practice generates a significant percentage of profit for Invocare and American operators, so we believe it'll add another stream of profit for FSY in the coming years.

With a market cap of circa AUD \$2.3bn, we think Fu Shou Yuan is a highly robust business and will be a long term compounding machine. Whilst we wouldn't buy the stock at current prices, we feel the entry price achieved for Blue Boat's investors last year gives us an opportunity for exceptional returns in the future.

Coming up in January and February all of our companies will be updating the market with results for the last half / quarter and many giving guidance for the year ahead. This will be an important time where we think there's a very good chance we will benefit from a solid set of numbers and will look to be opportunistic with trading opportunities when irrational reactions occur in stocks we understand well.

We feel confident about how the portfolio placed and again have elected to invest all fees back into the fund.

We hope to make these notes informative and interesting and we appreciate your feedback, so please keep it coming.

Finally, a reminder that our fund is open for new investment either from existing investors topping up or new unit holders at the current unit price of \$1.25. We have a list of stocks we're itching to buy and we see significant upside from our current list of stocks, so if you would like to top up your investment or refer someone who would potentially become an investor please don't hesitate to contact either of us.

Yours sincerely,

David Nelson and Tim Evans